

TENNESSEE GENERAL ASSEMBLY
FISCAL REVIEW COMMITTEE



**CORRECTED
FISCAL NOTE**

HB 1457 – SB 2649

March 8, 2018

SUMMARY OF BILL: Creates the Tennessee Taxpayer Relief and Economic Recession Reserve account (RRR) within the General Fund (GF). Requires the Commissioner of the Department of Finance and Administration, on or before November 1, 2019, and annually thereafter, to determine the amount of over collections from the previous year, based on the budgeted accrual estimate for the general appropriations act, as enacted prior to the beginning of the fiscal year in which the funds were collected. Defines “over collections” as state tax revenue collected above the budgeted accrual estimate that would otherwise be allocated to the GF, less certain funds earmarked for educational purposes, local governments, generated from fees paid to governmental entities, and allocations to the sinking fund account for payment of interest due on state bonds by the State of Tennessee.

If the balance of Reserve for Revenue Fluctuations (RRF) is less than 8 percent of the state tax revenues allocated to the GF and the Education Trust Fund (ETF) for the prior fiscal year, either (i) 25 percent of the over collections or (ii) the amount needed to bring the RRF to 8 percent of the state tax revenues allocated to the GF and the ETF for the prior fiscal year, whichever is less, shall be allocated to the RRF. The remainder of the over collections shall be allocated to the RRR.

If the balance of the RRF is not less than 8 percent of the state tax revenues allocated to the GF and the Education Trust Fund (ETF) for the prior fiscal year, then 100 percent of the over collections shall be deposited into the RRR.

Establishes acceptable means by which funds may be disbursed from the RRR, including offsetting non-recurring and unexpected shortfalls in state tax revenue. Any allocation of funds to the RRF or RRR is not counted as an appropriation from state tax revenue. Any appropriation of funds from RRF or RRR, other than to offset unexpected shortfalls in state tax revenue is counted as an appropriation from state tax revenue.

If the unobligated balance of the RRR exceeds \$150,000,000 on any January 1, then the 7 percent state sales tax shall be temporarily reduced to 6.75 percent during the month of September in the subsequent fiscal year unless the General Assembly enacts legislation specifying that the reduction shall occur in a different month or for a different number of months in the subsequent fiscal year. Establishes that it is the General Assembly’s intent to reduce the state sales tax rate for a maximum number of months possible without reducing the balance of the RRR below \$100,000,000. Requires the Department of Revenue, no later than July 1 of each year, to publish notice of any tax rate deduction on the Department’s website.

ESTIMATED FISCAL IMPACT:

On March 6, 2018, a fiscal note was issued for this bill estimating a fiscal impact as follows:

Other Fiscal Impact – Unknown transfers of future over collections, currently utilized to supplement the Reserve for Revenue Fluctuations (RRF) with the remainder deposited into the General Fund (GF) to fund future budgets, to the RRF at established rates, with the remainder deposited into the newly-created Taxpayer Relief and Economic Recession Reserve (RRR). Funds in the RRR will be used to offset any required decreases in the sales tax revenue to the GF due to the temporary state sales tax rate reduction, as established by the proposed legislation, or to offset unexpected shortfalls in state tax revenue. The extent and timing of any such impacts that may accrue to the state cannot be determined for such impacts are dependent upon future unknown factors. Further, any future impact to local government revenue cannot be reasonably determined.

Based on further review of the fiscal analysis, the assumptions and the estimated fiscal impact have been modified to more accurately reflect the impact of the proposed legislation. The estimated impact is as follows:

(CORRECTED)

Other Fiscal Impact – Unknown transfers of future over collections, currently utilized to supplement the Reserve for Revenue Fluctuations (RRF) with the remainder deposited into the General Fund (GF) to fund future budgets, to the RRF at established rates, with the remainder deposited into the newly-created Taxpayer Relief and Economic Recession Reserve (RRR). Funds in the RRR will be used to offset any required decreases in the sales tax revenue to the GF due to the temporary state sales tax rate reduction, as established by the proposed legislation, or to offset unexpected shortfalls in state tax revenue. The extent and timing of any such impacts that may accrue to the state cannot be determined for such impacts are dependent upon future unknown factors.

Corrected Assumptions:

- This legislation establishes a new account, the Tennessee Taxpayer Relief and Economic Recession Reserve account (RRR), within the General Fund (GF).
- Funds will be allocated to the RRR based on the amount of revenue collected over the budgeted accrual estimate (over collections) for the general appropriation act enacted prior to the beginning of the fiscal year in which the funds were collected.
- The following information was provided by the Department of Finance and Administration:

Fiscal Year	July 1 Estimate	Accrual Collections	Over/(Under) Collections	25 % of Over/(Under) Collection
FY10-11	\$4,491,000,000	\$4,654,467,800	\$163,467,800	\$40,866,950
FY11-12	\$4,734,900,000	\$5,190,798,100	\$455,898,100	\$113,974,525
FY12-13	\$5,044,400,000	\$5,401,931,800	\$357,531,800	\$89,382,950
FY13-14	\$5,592,700,000	\$5,284,019,400	(\$308,680,600)	-\$77,170,150
FY14-15	\$5,517,700,000	\$5,876,724,200	\$359,024,200	\$89,756,050
FY15-16	\$5,627,900,000	\$6,210,623,300	\$582,723,300	\$145,680,825
FY16-17	\$6,013,300,000	\$6,562,432,400	\$549,132,400	\$137,283,100

- The amount of over collections to be allocated to the RRR depends on the current balance of the reserve for revenue fluctuations (RRF), often cited as the “Rainy Day Fund,” and its proportion to the amount of funds allocated to the GF and Education Trust Fund (ETF) for the prior fiscal year.
- The following table shows the balance of the RRF for the last three fiscal years:

Balance of the Reserve for Revenue Fluctuations (RRF)	
Fiscal Year	Balance - RRF
FY14-15	\$491,500,000
FY15-16	\$568,000,000
FY16-17	\$668,000,000

- If the balance of the RRF is less than 8 percent of the state tax revenues allocated to the GF and ETF for the prior fiscal year, either (a) 25 percent of the over collections, or (b) the amount to bring the RRF to 8 percent of the state tax revenues allocated to the GF and the ETF for the prior fiscal year, whichever is less, shall be allocated to the RRF; and the remainder of the over collections shall be allocated to the RRR.
- If the balance of the RRF is not less than 8 percent of the state tax revenues allocated to the GF and ETF for the prior fiscal year, 100 percent of the over collections shall be deposited in the RRR.
- Column ‘D’ in the table below shows the amount needed for the RRF to reach eight percent of the tax revenues allocated to the GF and ETF for the previous three completed fiscal years:

Fiscal Year	(A) Accrual Collections - GF & ETF (over collections)	(B) 8 % of GF & ETF	(C) Balance - RRF	(D) Difference: (B) and (C)
FY14-15	\$10,588,863,600	\$847,109,088	\$491,500,000	\$355,609,088
FY15-16	\$11,257,133,600	\$900,570,688	\$568,000,000	\$332,570,688
FY16-17	\$11,764,921,900	\$941,193,752	\$668,000,000	\$273,193,752

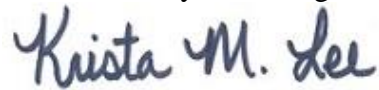
- Based on the previous three completed fiscal years, the proposed legislation would, at least for the foreseeable future, result in 25 percent of over collections being transferred to the RRF, with the remainder of the over collections transferred to the RRR.
- The three-year average for over collections is approximately \$496,960,000 $[(\$359,024,200 + \$582,723,300 + \$549,132,400) / 3]$.
- Assuming a similar trend continues in future years, 25 percent of such amount, or \$124,240,000 $(\$496,960,000 \times 25\%)$, would be transferred annually to the RRF, with the remaining amount, or \$372,720,000 $(\$496,960,000 - \$124,240,000)$ transferred to the RRR. The first fiscal year to which such transfer would apply is estimated to be FY19-20. It is assumed that over collections are currently used to supplement the RRF, with the remainder deposited into the GF to fund future budgets as recommended by the Governor and enacted by the General Assembly through the annual appropriations act.
- It is estimated that it would take several years, at a minimum, for the RRF to reach the 8 percent threshold at which point 100 percent of the over collections would be deposited into the RRR. Such future scenario is not considered in this fiscal analysis.
- Based on the assumptions above, it is assumed that the unobligated balance of the RRR would exceed \$150,000,000 on January 1, 2020, in FY19-20, which would trigger a state sales tax rate reduction from 7.00 percent to 6.75 percent.
- Such reduction is assumed to take place in September 2020 (FY20-21) only. Pursuant to the requirements of the proposed legislation, any decrease associated with such tax rate reduction would be from the increase imposed pursuant to Public Chapter 856 § 4 of the Public Acts of 2002.
- Public Chapter 856 § 4 increased the state sales tax rate from 6.00 percent to 7.00 percent and established that all revenue generated from the tax rate increase shall be paid into the GF and allocated exclusively for general state purposes.
- Therefore, any decrease in revenue resulting from a temporary state sales tax rate reduction would impact the GF only. Subsequently, funds from the RRR would be transferred to the GF to offset any such decrease.
- The Fiscal Review Committee staff's sales tax estimate generated from the 7 percent sales tax rate in FY18-19 is approximately \$8,396,000,000. This number is assumed to remain constant into perpetuity for purposes of this fiscal analysis.
- September sales tax activity is reflected in October state sales tax collections. Based on FY16-17 sales tax collections, October collections represent approximately 8.4 percent of total sales taxes collected from the 7 percent sales tax rate. Therefore, it is estimated that, under current law, October 2020 collections would be equal to \$705,264,000 $(\$8,396,000,000 \times 8.4\%)$.
- Decreasing the sales tax rate from 7.00 percent to 6.75 percent in such month would result in a decrease in revenue to the GF of \$25,188,000 $\{ \$705,264,000 - (\$705,264,000 / 7.00\%) \times 6.75\% \}$, and an equivalent transfer of such amount from the RRR to the GF in FY20-21. Any subsequent tax rate decreases in FY20-21 enacted by the General Assembly would increase the estimated loss in sales tax revenue and the estimated equivalent transfer of funds from the RRR to the GF.
- In summary and for illustrative purposes, and based on historical data from the previous three-year period, the first year impacted by such transfer of funds may be FY19-20, with an estimated transfer of \$496,960,000 in over collections to the RRF (\$124,240,000) and to the RRR (\$372,720,000). The first year impacted by the

temporary state sales tax rate decrease could be FY20-21, with an estimated loss of at least \$25,188,000 in sales tax revenue to the GF, which will be offset by an equivalent transfer of funds from the RRR to the GF. Subsequent transfers of funds and temporary state sales tax rate reductions could occur in any subsequent fiscal year.

- Any increase in state expenditures for the Department of Revenue or the Department of Finance and Administration to accomplish the requirements of the proposed legislation will be not significant.

CERTIFICATION:

The information contained herein is true and correct to the best of my knowledge.

A handwritten signature in blue ink that reads "Krista M. Lee". The signature is written in a cursive, flowing style.

Krista M. Lee, Executive Director

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